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Rental Property 2008 Tax Tips

GET AN ATO COMPLIANT TAX DEPRECIATION SCHEDULE!

A Quantity Surveyor prepared Tax Depreciation Schedule is one of the best investments a property investor can make. Claiming the maximum allowable depreciation can save you thousands of dollars every year for sometimes up to 40 years.

A Tax Depreciation Schedule is simply a report on all the items in an investment property that are decreasing in value. For properties built after 18th July 1985 this includes the building itself and if your property qualifies, it is important that the construction cost be estimated by a quantity surveyor in the absence of original construction data being available from the vendor. A number of firms that supply tax depreciation schedules do not use Quantity Surveyors which so it is important to check!

All investment properties can have their assets depreciated and even older properties often contain sufficient fixtures and fittings to make them viable candidates for a professionally prepared Tax Depreciation Schedule. Most renovations carried out after 18 July 1985 even by previous owners can be depreciated.

The cost of a Tax Depreciation Schedule is 100% tax deductible and you should have it done well before you plan to visit your accountant and lodge your return.

Remember to pay for it by June 30 and you can claim the cost soon after that.

JOINTLY OWNED INVESTMENT PROPERTIES

Joint owners of an investment property can gain greater access to cash flow benefits by using the low value pool and immediate write off rules. This is because the low value pool (assets that cost under $1,000) and immediate write off (assets that cost under $300) rules are applied to each owner's interest in the asset, NOT the asset as a whole. This means that if an investment property is owned equally by two individuals, assets costing up to $2,000 can be depreciated

as part of a low value pool and assets costing less than $600 will be able to be written off - $300 by each owner.

However, join property owners also need to be aware of their responsibilities. Joint owners must divide the investment income and expenses proportional to their legal ownership. No written agreements can overwrite the legal ownership interests!

Also, if one of the owners of an investment property moves into the property, it ceases to be an investment for that owner's portion of the investment. The other owner, who does not live in the property, can still claim their portion of the income and expenses proportionate to their ownership. In this case, it is important that the joint owner living in the property pays a market value rent and pays the appropriate percentage to the other owner.

CORRECT RENTAL INCOME

The ATO has said that this year they are on the look out for low rental incomes compared to deductions. Apart from claiming standard rental income, many property investors forget to include amounts from rental bonds that are withheld from the tenant because of damages. Another common omission for rental income is insurance payouts from lost rent, damage claims or the reimbursement of any rental expenses that were insured against.

Renting a property to a family member or friend is fine, as long as they are paying market value rent. This situation is one that the ATO is looking out for so if you do rent your property to a friend or family member, you should keep documentation that shows that the rent amount is a fair market rate.

CORRECT RENTAL EXPENSES

At tax time, claiming the correct rental expenses is one of a property investor's most important jobs and landlords that only rented the property for part of the year will need to apportion correctly.

You are only able to claim expenses during periods when the property is available for rent. So for example, if you had a holiday in the property, you will need to apportion the time you spent there and not claim the interest during that time.

Expenses also include ongoing maintenance costs such as agent fees, professional fees like an accountant or quantity surveyor, repair and servicing costs like a plumber, insurances and costs associated with looking after the property and your investment. Just be careful not to claim an immediate deduction for a capital cost (like any building items or improvements you may have made).

With borrowing expenses, they are able to be expensed over 5 years and these include stamp duty on a mortgage (not the stamp duty on the property purchase), mortgage insurance if applicable and legal expenses for the loan (not legal expenses on the property purchase, which is a capital expense and factored in at the Capital Gain Event).

You can also prepay expenses in this financial year to increase your deductions. You can do this for costs that relate to only the next year (not beyond) and you should be aware that this only brings the expense forward and reduces the expenses you would normally pay next financial year (and you may want more expenses next year!)

KNOW THE DIFFERENCE BETWEEN A REPAIR AND AN IMPROVEMENT

It is important for property investors to know the difference between a repair and an improvement so that you maximise your claim legally. A repair is generally defined as 'restoring something to the condition it was in when it was purchased' and usually involves fixing part of an asset. Getting one of your broken hotplates on your stove fixed is a repair. So is fixing a leaking tap and replacing the element in a hot water heater. Repairs can be claimed as an immediate deduction.
An improvement is when you improve the condition of the asset and these need to be depreciated over the ATO's appropriate effective life. So buying a brand new stove to replace the 'tired & old' stove is an improvement. In most cases, so is replacing the entire roof or painting the entire property. Be sensible!

MIXING INVESTMENT AND PERSONAL AFFAIRS

Make sure that you are not claiming a deduction for any interest on your personal loans. Line of Credit (LOC) loans can be tricky. If you have drawn down funds for your investment property and for personal expenditure, you need to separate them.

Also, if you have used any investment loans to spend on personal expenses like buying a car, renovations on house that you live in or a holiday, you cannot claim the interest that you pay on those amounts as a deduction. They are personal expenses and the interest will also need to be.

One of the most common and easily identifiable errors in mixing investment and personal expenses is with visiting your investment property…..

JUSTIFIABLE TRAVEL & ACCOMMODATION EXPENSES

You are entitled to claim for travel, vehicle and accommodation expenses which relate directly to the management of your investment property. Any proportion of a trip to your investment property that was also for a holiday is not claimable. So if you inspect your property for 1 day but stay for 7, you would only be able to claim 1/7th of the expenses.

It is important to keep a good record of all these details and only claim what are genuine expenses. Log books and odometer readings for your vehicle, airfares and receipts could be required for justification.

KEEP GOOD RECORDS

If you are one of the thousands of property investors that will get a letter from the ATO this year, make sure you have good records to substantiate your tax return. Apart from keeping all your agent statements, bank statements, council fees and utility bills, it could also be wise to keep other documentation as it could save you later.

If you are self valuing your investment property for the purposes of transferring the asset to someone else, appropriate documentation includes a real estate agent's letter with examples of recent sales of other similar properties in the area or historical sales records.

If you incur costs associated with managing your investment property like phone calls and stationery, make sure you keep the receipts. If you drive your car to manage your investment property, keep a log book of kilometers traveled.

If you rented your property out for only part of the year, keep records to prove when the property became available for rent.

Remember, you can only claim expenses if you actually incur them. So if you engage a plumber to do a job for you cheaply because you pay him cash, you need to get a receipt and claim only the amount you paid – you cannot claim for the market value of the work done.

PROTECT YOURSELF

It's important you protect yourself and your investment. The best way to do this is to ensure you are adequately insured. The cost of Building/Contents insurance and Landlord insurance is tax deductible and can be very useful in the case of tenants causing damage or 'doing a runner'!

If you are an employee and have a salary, you may also have income protection insurance, which is a deductible cost and can be important if you could not work for some reason and still needed to pay your investment property mortgage.

Investors should be aware of the use of trusts for asset protection and the potential for significant tax savings. Be aware that not many accountants or lawyers are familiar with these structures so it is important to find an accountant with experience in this area, particularly given the ATO is on the look out for some types of trusts.

Taking the time to learn what claims you are entitled to make at tax time, especially as a property investor, means you will maximise your savings, claim correctly without mistakes and therefore stay under the radar of the ATO

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